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< [Back to Regular Story Page](#)

A profitable approach to online video

HULU : Upstart site outshines its giant competitor, YouTube

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SAN JOSE, Calif. – A battle of quality versus quantity is shaping up in the online video world, as upstart Web site Hulu takes on YouTube, the reigning giant.

Although YouTube has huge traffic and name recognition, Hulu, which focuses solely on Hollywood-produced content, may turn out to be the better business.

“I don’t know who’s going to come out ahead,” said Elizabeth Curtis, associate analyst for consumer markets at IDC, a technology industry research firm. In the ad-supported video market, she added, “it will be between them to duke it out.”

At first glance, the fight seems an unfair one. Almost since its debut in late 2005, YouTube has dominated the online video world. The Google-owned site is the destination of choice for just about anyone who wants to post a video online. In March, YouTube served up 5.9 billion video streams to its U.S. users alone, according to comScore, a market research firm. That was nearly 16 times more than the number watched on Hulu.

But Google has famously struggled to turn that traffic into money. YouTube, like Hulu, allows consumers to watch videos for free, hoping to make money by selling ads. But more than two years after Google spent \$1.7 billion to buy the site, YouTube still isn’t generating “significant revenue” for the company, Google acknowledged in its annual report for last year.

That’s a problem for Google investors, who have become increasingly worried about how much of a drag YouTube is on the company’s bottom line, and whether the search giant will ever see a return on its investment in the company. In 2005 and 2006, YouTube lost \$271 million and \$276 million, respectively, according to Google’s financial filings. Google no longer breaks out YouTube’s financial results, but Credit Suisse financial analyst Spencer Wang earlier this month estimated that the site would post an operating loss of \$470 million on \$240 million in revenue.

Hulu entered the online video market with a different idea. Instead of letting anyone post a video, the company, backed then by two leading Hollywood studios, is focused entirely on professionally produced content, such as movies and recent episodes of TV shows.

That formula has produced an instant success. Little more than a year after its debut, Hulu now is the third most popular video site in terms of videos viewed through it, according to comScore.

Offering a much larger selection of Hollywood-produced content than any other ad-supported Internet video service, Hulu has become the destination of choice for watching TV or movies online. And its lead is growing. Just last week, Disney signed on as a partner to Hulu, joining the site’s 150 content partners, which include all of the major television production companies except CBS.

While the overall number of videos available through Hulu is minuscule compared with what’s available through YouTube, Hulu focuses on the ones most attractive to advertisers. Hulu doesn’t disclose its finances,

but online advertising experts estimate that its advertising rates are several times higher than YouTube's.

“Generating revenue from user-generated content is very, very difficult, and that's probably being generous,” said Josh Martin, a senior analyst at the Yankee Group, a technology research firm. “The reason Hulu's been successful is that it's providing the content that people want.”

That's left YouTube to play catch up. Since November, the company has added TV shows, movies and other videos from the likes of Sony Pictures, CBS, MGM and ABC. Earlier this month, the site added a new section called “Shows” to promote its collection of Hollywood-produced videos. YouTube now has more than 500 Hollywood movies on its site, including “Super Size Me” and the remake of “The Mod Squad.”

YouTube representatives say many of these deals have been in the works for more than a year, and don't represent a direct response to Hulu. Instead of seeing Hulu as simply a threat, they say the site has helped expand the market.

Hulu has shown that users will tolerate video ads – at least if they are paired with the right content – and are interested in watching longer-form videos on the Web, said Graham Bennett, YouTube's strategic partner manager.

But YouTube has a small fraction of the full-length, professionally produced content that consumers can find on Hulu. Even if YouTube can broaden its selection, it may have trouble luring consumers because many now think of the site as the place to get user-produced videos, noted Robert Passikoff, president of Brand Keys, a consulting firm. For Hollywood-produced ones, they're turning to Hulu.

“When your brand is so deeply entrenched in that kind of milieu, it's real hard to turn around,” Passikoff said.

That doesn't mean the fight's over. The online video market is still a nascent one, and neither YouTube nor Hulu has everything viewers or advertisers want.

YouTube has the mass audience that advertisers crave. But many advertisers aren't interested in associating their brands with the low-quality, homegrown videos that comprise the bulk of YouTube's offerings. And few individual videos on the site reach more than a small fraction of YouTube's audience, so advertisers would have to place ads on dozens or hundreds of videos to reach a large audience.

Hulu, meanwhile, has the premium content that advertisers know and love. But it doesn't come close to YouTube's traffic or overall viewership. And for advertisers who are used to reaching a television audience numbered in the millions, finding big audiences online is all-important, notes Michael Hayes, executive vice president at Initiative, a media marketing company.

“We're going to go where the eyeballs are,” Hayes said.

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